

HR Alert: COBRA CHANGES

June 30, 2009

Just in case you are not already aware of the new COBRA requirements. From Ceridian.

QUERY: Can you explain the recent changes in COBRA?

RESPONSE: The following material is found in Ceridian's HR Compliance Reference System:

Expansion of COBRA Law in the American Recovery and Reinvestment Act of 2009

Responding to increasing unemployment from the dramatic downturn affecting all sectors of the economy, the U.S. Congress expanded the premium and notice obligations of employers under COBRA.

Provisions in the American Recovery and Reinvestment Act of 2009 (ARRA) create a federal COBRA premium subsidy for ***assistance-eligible individuals*** — covered employees and their dependents who are involuntarily terminated from their jobs between September 1, 2008, and December 31, 2009, and who are otherwise eligible for COBRA during this period.

These assistance-eligible individuals are only required to pay 35 percent of their COBRA premiums for a maximum of nine months. The remaining 65 percent of the premium is paid by the employer, which is reimbursed through a reduction in federal payroll tax obligations. The COBRA subsidy is nontaxable to the assistance-eligible individual.

The new provisions also include the following:

- ◆ Second chance COBRA elections.
- ◆ New election options.
- ◆ Revised COBRA notices.
- ◆ Modified COBRA invoices.
- ◆ Interactions with payroll tax deposit mechanisms to fund the 65 percent subsidy.
- ◆ New reporting to the Secretary of the Treasury and assistance-eligible individuals.
- ◆ Adverse individual income tax consequences for assistance-eligible individuals who earn too much income in 2009 or 2010.

Subsidy Details

Amount of Subsidy

Under normal circumstances, an employer may charge qualified beneficiaries who have elected COBRA continuation coverage 102 percent of the total cost of coverage. For qualified beneficiaries covered by the ARRA, however, an employer may charge the qualified beneficiary only 35 percent of the total COBRA premium, and the employer must pay the remaining 65 percent of the cost and be reimbursed through a payroll tax credit.

Calculation of Premium Reduction

The premium used to determine the 35 percent share that must be paid by (or on behalf of) an assistance-eligible individual is the cost that would be charged to the assistance-eligible individual for COBRA continuation coverage if the individual were not an assistance-eligible individual.

If, without regard to the subsidy, the assistance-eligible individual is required to pay 102 percent of the applicable premium for continuation coverage, generally the maximum permitted under the federal COBRA rules, the assistance-eligible individual is required to pay only 35 percent of the 102 percent of the applicable premium.

However, if the premium that would be charged the assistance-eligible individual is less than the maximum COBRA premium (for example, if the employer subsidizes the coverage by paying all or part of the cost), the amount actually charged the assistance-eligible individual is used to determine the assistance-eligible individual's 35 percent share.

Coverage Eligible for Premium Reduction

The premium reduction is available for COBRA continuation coverage of any group health plan, except a flexible spending arrangement (FSA) under I.R.C. § 106(c) offered under a § 125 cafeteria plan. This includes vision-only or dental-only plans and "mini-med plans," whether or not the employer pays for a portion of the costs for active employees.

Note: The premium reduction is available for COBRA continuation coverage under a health reimbursement arrangement (HRA). While an HRA may qualify as an FSA under § 106(c), the exclusion of FSAs from the premium reduction is limited to FSAs provided through a § 125 cafeteria plan, which would not include an HRA.

The premium reduction is not available for continuation coverage offered by employers for nonhealth benefits that are not subject to COBRA continuation coverage, such as group life insurance.

Effective Date

The subsidy is available for any period of coverage beginning on or after February 17, 2009. In other words, if COBRA coverage is provided based on the first of each month, the subsidy is available beginning March 1, 2009.

Grace Period

In light of the almost immediate application of the new COBRA rules, the stimulus bill provides a grace period for employers or COBRA administrators who are unable to modify March or April COBRA bills for assistance-eligible individuals in time to reflect the 65 percent subsidy. The grace period permits charging the full COBRA premium for two billing periods, followed by an appropriate credit in subsequent billing periods equal to the missed 65 percent subsidy or, alternatively, a reimbursement to the assistance-eligible individual. Special rules apply if it is apparent or becomes apparent that the credit cannot be used by the assistance-eligible individual within 180 days.

Duration

If an individual is eligible for the COBRA subsidy, that eligibility will continue until the earliest of:

- ◆ Nine months following the date the individual is first eligible for the subsidy.
- ◆ The date that the eligible individual becomes eligible for Medicare benefits or health coverage under another group health plan (including, for example, a group health plan maintained by a new employer of the individual or a plan maintained by the employer of the individual's spouse).

It is important to note that the subsidy ends on mere eligibility, whereas COBRA coverage ends when the individual is actually covered. However, the individual will remain eligible for the subsidy if the other group health plan provides only dental, vision, counseling, or referral services (or a combination of the foregoing), is a health flexible spending account or health reimbursement arrangement, or is coverage for treatment that is furnished in an on-site medical facility maintained by the employer and that consists primarily of first-aid services, prevention and wellness care, or similar care (or a combination of such care).

- ◆ The date the maximum continuation coverage period under COBRA expires. (The ARRA does not extend the maximum COBRA continuation coverage periods.)

- ◆ The assistance-eligible individual fails to pay the required 35 percent share of the COBRA premium.

Eligibility Requirements

Assistance-Eligible Individual

An individual must be an assistance-eligible individual to be eligible for the premium reduction.

Under ARRA, an assistance-eligible individual is generally an individual who:

- ◆ Is a qualified beneficiary as the result of an involuntary termination during the period from September 1, 2008, through December 31, 2009.
- ◆ Is eligible for COBRA continuation coverage at any time during that period.
- ◆ Elects the coverage.

In order to be a qualified beneficiary, the individual must be covered under the group health plan on the day before the involuntary termination.

For purposes of federal COBRA, an individual who loses group health coverage in connection with the termination of a covered employee's employment by reason of the employee's gross misconduct is not a qualified beneficiary and thus cannot be an assistance-eligible individual.

Involuntary Termination

An essential requirement for subsidy eligibility is that individuals must have been involuntarily terminated (other than for gross misconduct) between September 1, 2008, and December 31, 2009. Individuals who have COBRA-qualifying events other than involuntary termination, such as divorce or voluntary termination, are ineligible for the subsidy. The new law, however, failed to define "involuntary termination."

IRS Notice 2009-27 provided clarification on several issues regarding the COBRA subsidy, including the definition of involuntary termination. The notice broadly defines involuntary termination as being "a severance from employment due to the independent exercise of the unilateral authority of the employer to terminate the employment." Although the guidance focuses on employer action, it also recognizes certain employee-initiated terminations as being involuntary if the employee was terminated for good reason based on "employer action that causes a material negative change in the employment relationship."

The IRS further indicates that whether a termination is involuntary is based on all the facts and circumstances. For example, if a termination is designated as voluntary or as a resignation, but the facts and circumstances indicate that, absent such voluntary termination, the employer would have terminated the employee's services, and that the employee had knowledge that the employee would be terminated, the termination is involuntary.

More specifically, the notice sets forth the following situations which are likely to constitute an involuntary termination:

- ◆ The employer's failure to renew a contract at the time the contract expires, if the employee was willing and able to execute a new contract providing terms and conditions similar to those in the expiring contract and to continue providing the services.
- ◆ An employee-initiated termination from employment, if the termination from employment constitutes a termination for good reason due to employer action that causes a material negative change in the employment relationship for the employee.
- ◆ An involuntary reduction to zero hours, such as a lay-off, furlough, or other suspension of employment, resulting in a loss of health coverage.
- ◆ An employee's voluntary termination in response to an employer-imposed reduction in hours, if the reduction in hours is a material negative change in the employment relationship for the employee.
- ◆ A lockout initiated by the employer.

- ◆ An employer's action to end an individual's employment while the individual is absent from work due to illness or disability (although mere absence from work due to illness or disability before the employer has taken action to end the individual's employment status is not an involuntary termination).
- ◆ Retirement, if the facts and circumstances indicate that, absent retirement, the employer would have terminated the employee's services, and the employee had knowledge that the employee would be terminated.
- ◆ A termination for cause.
- ◆ Resignation as the result of a material change in the geographic location of employment for the employee.
- ◆ A termination elected by the employee in return for a severance package (a "buy-out") where the employer indicates that after the offer period for the severance package, a certain number of remaining employees in the employee's group will be terminated.

An involuntary termination generally does not include:

- ◆ A mere reduction in hours, if the reduction in hours is not a reduction to zero. However, an employee's voluntary termination in response to an employer-imposed reduction in hours may be an involuntary termination if the reduction in hours is a material negative change in the employment relationship for the employee.
- ◆ A work stoppage as the result of a strike initiated by employees or their representatives (however, a lockout initiated by the employer is an involuntary termination).
- ◆ Qualifying events such as divorce or a dependent child ceasing to be a dependent child under the generally applicable requirements of the plan (such as loss of dependent status due to aging out of eligibility).
- ◆ Death of an employee or absence from work due to illness or disability.

Dependent Coverage

The 65 percent subsidy also applies to any family members who independently elect COBRA due to an involuntary termination of employment of an assistance-eligible individual.

State Law Continuation Coverage

Individuals are eligible for the COBRA premium subsidy if they are entitled to continued health coverage under a comparable state law, even when they are not entitled to federal COBRA (due to, for example, the small employer exception to federal COBRA).

Comparable continuation coverage under state law does not include every state law right to continue health coverage, such as a right to continue coverage with no rules that limit the maximum premium that can be charged with respect to such coverage. To be comparable, the right generally must be to continue substantially similar coverage as was provided under the group health plan (or substantially similar coverage as is provided to similarly situated beneficiaries) at a monthly cost that is based on a specified percentage of the group health plan's cost of providing such coverage.

A different period of continuation coverage under state continuation coverage programs does not disqualify the state program from being comparable. For example, the fact that a state continuation coverage program only provides for six months of continuation coverage (instead of 18 months) would not result in the state program failing to be comparable. Similarly, state programs providing for different qualifying events, different qualified beneficiaries, or different maximum premiums generally do not fail to be comparable solely for those reasons.

Domestic Partner

The subsidy apparently does not apply to the cost of any COBRA-like coverage offered to domestic partners, civil union partners, or same-sex spouses unless they are dependents under the modified terms of IRC § 152.

Income Limitations

An assistance-eligible individual will be entitled to the subsidy, if during the year in which the subsidy would be received, the individual has adjusted gross income that exceeds \$145,000 (or \$290,000 if filing a joint return); however, there are income tax implications for taking the subsidy.

For an individual with adjusted gross income between \$125,000 and \$145,000 (\$250,000 to \$290,000 for joint filers), the amount of the individual income tax liability is reduced.

The ARRA applies the income limitation by requiring that the assistance-eligible individual repay the subsidy on the individual's federal income tax return. Thus, it is not necessary for the employer or other plan sponsor providing COBRA coverage to determine whether the assistance-eligible individual's adjusted gross income exceeds the income limitation.

A plan cannot refuse to provide the premium reduction to an individual because of the individual's income. Even if an assistance-eligible individual's income is high enough that the recapture of the premium reduction would apply, COBRA continuation coverage must be provided upon payment of 35 percent of the premium unless the individual has notified the plan that the individual has elected the permanent waiver of the premium reduction, or the period for the premium reduction has ended.

An assistance-eligible individual who wants to make a permanent election to waive the right to the premium reduction makes the election by providing a signed and dated notification (including a reference to "permanent waiver") to the person who is reimbursed for the premium reduction. There is no separate additional notification to any government agency.

If an assistance-eligible individual makes the permanent election to waive the right to the premium reduction, the individual may not later reverse the election and may not receive the premium reduction for any future period of COBRA continuation coverage in 2009 or 2010, regardless of modified adjusted gross income in those years.

Special Election Period

Congress recognized that many individuals who were recently terminated may have declined to elect COBRA continuation coverage because of its cost. Accordingly, the act includes a special election opportunity for assistance-eligible individuals who were eligible to elect COBRA coverage when they were terminated from employment, but did not so elect. These individuals are entitled to an extended election period that begins on the date of the ARRA's enactment, and ends no sooner than 60 days after an extended election notice is provided to the individuals.

Important: This extended election period does not change the fact that the individual's termination from employment remains the qualifying event for purposes of COBRA.

The ARRA requires employers to attempt to locate former employees who previously declined COBRA and provide notice of the right to COBRA coverage with the government subsidy.

If an eligible individual elects COBRA continuation coverage during the special extended election period, COBRA coverage will commence with the first period of coverage beginning on or after the enactment of the ARRA, and is not retroactive to the original date that benefits terminated under the plan.

However, for purposes of determining the maximum COBRA coverage period, the date of the individual's involuntary termination of employment (or the date of the loss of coverage resulting from such termination, if applicable) will continue to be treated as the qualifying event. This means that the COBRA continuation coverage period available to an individual who makes an election during the extended election period will be determined based on the date of the qualifying event as previously described. For example, an assistance-eligible individual terminated on September 30, 2008, who makes a timely election during the extended election period, generally will be entitled to COBRA continuation coverage prospectively beginning March 1, 2009, though the 18-month maximum coverage period is measured from October 1, 2008.

Effect on Pre-Existing Condition and Creditable Coverage Limitations

Under the Health Insurance Portability and Accountability Act (HIPAA) creditable coverage and pre-existing condition limitations rules, a plan may refuse to cover pre-existing conditions for a certain period of time for an individual who has a 63-day break in coverage. In the case of individuals who are able to take advantage of the second chance special election and who elect COBRA coverage during this new election period, the period of time beginning with the qualifying event and ending on the effective date of the newly elected COBRA coverage will not be counted as a break in coverage for purposes of this 63-day rule.

Option to Change Coverage

Under COBRA, a qualified beneficiary generally is entitled only to elect continuation of the same coverage option the individual was receiving on the day before the date of the qualifying event. However, the ARRA permits employers to be flexible, but does not require them to do so. Assuming different coverage options are available, an assistance-eligible individual may enroll in coverage under a plan that is different than the coverage in which the individual was enrolled at the time the qualifying event occurred.

To make this change, the assistance-eligible individual must make an election change within 90 days after the notice is provided. Such election must be permitted by the employer if the employer has chosen to offer the option.

The premium for such coverage must not exceed the premium for the coverage in which the individual was enrolled prior to termination of employment.

In addition, the different coverage also must be offered to active employees at the time the election is made, and the different coverage may not be coverage providing only dental, vision, counseling, referral services (or a combination of these), or coverage under a flexible spending arrangement or coverage that provides services at certain on-site medical facilities.

Mechanism for Subsidy and Reimbursement

Payroll Tax Offsets

The stimulus plan contains a unique process for funding the 65 percent subsidy. Assistance-eligible individuals will only pay 35 percent of the ordinary COBRA premium directly to the employer, COBRA administrator, multi-employer plan, insurer, or government employer. After receipt of the subsidized payment, the recipient is directed to reduce its payroll tax deposits by an amount equal to the remaining 65 percent of the COBRA premium. For this purpose, payroll tax deposits represent federal income tax wage withholdings and the employer and employee share of FICA tax withholding. The employer (or other recipient of the 65 percent subsidy) will be treated as if it had paid payroll taxes to the Secretary of the Treasury in an amount equal to the subsidy.

For entities that offer COBRA coverage but do not collect payroll taxes, these entities (such as multi-employer plans) will receive a credit or refund check directly from the Secretary of the Treasury in an amount equal to the 65 percent subsidy.

Payment of the subsidy to an employer or another entity is not treated as income, but rather as an employee contribution to a group health care plan.

Reporting Requirements

Under the ARRA, a health plan or employer entitled to reimbursement for the subsidy must submit these reports to the Secretary of the Treasury:

- ◆ An attestation of involuntary termination of employment for each assistance-eligible individual for whom a reimbursement is claimed.
- ◆ A report of the amount of payroll taxes offset for the reporting period and estimated offsets of such taxes for the subsequent reporting period.
- ◆ A report containing the tax identification numbers of all assistance-eligible individuals, the amount of subsidy reimbursed with respect to each assistance-eligible individual, and a designation with respect to each assistance-eligible individual as to whether the subsidy reimbursement is for coverage of one individual or two or more individuals.

The act requires the Secretary of the Treasury to issue regulations or other guidance to assist employers and plans with reporting such information.

Notice Requirements

Employers, COBRA Administrators, and Insurers

Employers, COBRA administrators, or insurers must provide updated COBRA notices (or a separate notice) by no later than April 18, 2009, describing the subsidy to all individuals who became eligible for COBRA between September 1, 2008 and February 17, 2009. Similar enhanced notices must be given on an ongoing basis for all new COBRA-qualified beneficiaries through December 31, 2009. The new information will become a part of the standard COBRA notice during the subsidy period.

The COBRA notice must now include the following information:

- ◆ The availability of the COBRA subsidy.
- ◆ A description of the option to enroll in different coverage, if the employer permits.
- ◆ The forms necessary for establishing eligibility for a COBRA subsidy.
- ◆ The name, address, and telephone number necessary to contact the plan administrator and any other person maintaining relevant information in connection with the COBRA subsidy.
- ◆ A description of the extended election period.
- ◆ A description of the obligation of assistance-eligible individuals to notify the plan when they cease to be eligible for the COBRA subsidy and the penalty for failing to do so.
- ◆ A prominent description of the assistance-eligible individual's right to the COBRA subsidy and any conditions on that right.

A failure to provide the notices will be treated as a failure to meet the COBRA notice requirements, which could subject the employer or plan to penalties and excise taxes.

Note: The ARRA does not affect the timing of notices sent to individuals who become qualified beneficiaries on or after February 17, 2009. Such notices must be provided to employees no later than 44 days after a qualifying event.

Model Notices

The Employee Benefits Security Administration (EBSA) released four model notices that incorporate the requirements of the ARRA, including the premium subsidy available to COBRA participants and the opportunity to elect COBRA coverage for qualified beneficiaries who previously declined coverage or discontinued the coverage.

The four notices may be used immediately after the employer inserts certain employer-specific information. The notices cover four situations:

- ◆ A general notice to all COBRA-qualified beneficiaries (including spouses and dependents) who have experienced or will experience a qualifying event between September 1, 2008, and December 31, 2009. This notice applies to all qualifying events, not just involuntary terminations.
- ◆ An abbreviated version of the general notice, which may be used for active COBRA-qualified beneficiaries (who elected COBRA and are currently covered because of an involuntary termination occurring on or after September 1, 2008) to advise them of the reduced premium and related information.
- ◆ A notice regarding extended election periods, which may be used for former employees (and their spouses and dependents) who experienced an involuntary termination between September 1, 2008, and February 16, 2009, and either:
 - Could have elected COBRA coverage but declined to do so.
 - Elected COBRA coverage and subsequently discontinued it.

- ◆ A notice that may be used by employers who are not covered by COBRA but are covered by similar state laws, often known as mini-COBRA laws. This notice will require some revision to make it consistent with the mini-COBRA law in the state in which the employer operates.

If an employer is uncertain whether an individual is entitled to additional COBRA rights under the ARRA because the employer is unsure whether the employee was terminated involuntarily, the employer should still send the applicable notice and allow the individual to state their position as to whether the termination was involuntary.

In addition to the notices, the Department of Labor has issued several supporting documents that should be provided along with the appropriate notice. These documents include a continuation coverage election form, a summary of the premium reduction rules, a form to request eligibility for the premium reduction (as an "assistance eligible individual"), a form to allow qualified beneficiaries to switch coverage options (if the plan normally allows such changes), and a form that qualified beneficiaries can use to notify the plan if they become eligible for coverage under another group health plan or Medicare.

Model Notice Frequently Asked Questions

Q To whom should plans subject to the federal COBRA provisions send the full version of the general notice (*Model General Notice – full version*)?

- A Plans subject to the federal COBRA provisions must send the full version of the general notice to individuals who:
- Are qualified beneficiaries (not just covered employees).
 - Experienced a qualifying event at any time from September 1, 2008 through December 31, 2009 (regardless of the type of qualifying event).
 - Either have not yet been provided an election notice or who were provided an election notice on or after February 17, 2009 that did not include the additional information required by the ARRA.

Q Is a qualified beneficiary whose qualifying event was, for example, divorce, aging out of dependent coverage, or voluntary termination of employment, entitled to a general notice?

- A Yes, if the qualified beneficiary meets all the other applicable criteria; that is, the type of qualifying event does not matter for purposes of the general notice.

Q Who should receive the abbreviated version of the general notice (*Model General Notice – abbreviated version*)?

- A The abbreviated version of the general notice, which includes the same information as the full version regarding the availability of the premium reduction and other rights under the ARRA, but does not include the COBRA coverage election information, may be sent in lieu of the full version to individuals who:
- Have experienced a qualifying event on or after September 1, 2008.
 - Have already elected COBRA coverage.
 - Currently have COBRA coverage.

Q Who is required to send the alternative notice (*Model Alternative Notice*)?

- A States may impose separate continuation coverage requirements on health insurance issuers. Health insurance issuers that provide group health insurance coverage comparable to COBRA should send the alternative notice to individuals covered by state-mandated continuation coverage laws (including mini-COBRA laws). Continuation coverage requirements vary among states. Therefore, issuers should conform these notices to applicable state law.

Q Who should receive the notice in connection with extended election periods (*Model Notice in Connection with Extended Election Periods*)?

- A Plans subject to the federal COBRA provisions must send the notice in connection with extended election periods to any assistance eligible individual (or any individual who would be an assistance eligible individual if a COBRA continuation election were in effect) who:
- Had a qualifying event that was an involuntary termination of employment at any time from September 1, 2008 through February 16, 2009.
 - Either did not elect COBRA continuation coverage, or elected but subsequently discontinued COBRA.

This notice must include information regarding ARRA's additional election opportunity, as well as premium reduction information, and must be provided by April 18, 2009.

Q Are issuers subject to comparable state continuation coverage requirements required to send the notice in connection with extended election periods?

- A Issuers are not required to send this notice under ARRA. However, state laws may require an additional election period and may require issuance of a similar notice.

Additional Guidance

The Department of Labor has also released a series of frequently asked questions to assist employers, employees, and qualified beneficiaries in determining their rights and obligations under the ARRA. This guidance was expanded on March 19, 2009. Questions related to the premium reduction, notice requirements, and certain appeals by employees are addressed. There is also a link to guidance from the Internal Revenue Service (IRS) on the payroll tax credit available under ARRA.

Employers should familiarize themselves with this latest information from the Department of Labor so that they will continue to be in compliance with the COBRA changes imposed by the ARRA. The model notices and accompanying documents are useful tools that can make compliance easier and less costly.

Qualified Beneficiaries

Qualified beneficiaries are obligated to notify their group health plan, in writing, upon becoming eligible for another group health plan or Medicare. Simply ceasing to pay COBRA premiums is not sufficient notice under the ARRA. A qualified beneficiary's failure to notify the group health plan of the cessation of eligibility for the subsidy may subject the qualified beneficiary to a penalty of 110 percent of the amount of the subsidy.

